

Washington State Department of Transportation's FFY 2007 Overall DBE Goal

The Washington State Department of Transportation (WSDOT) submits this Disadvantaged Business Enterprise (DBE) goal methodology to the U.S. Department of Transportation's Federal Highway Administration (FHWA) for review and approval pursuant to 49 CFR §26.45 to establish the overall DBE goal for its federally-assisted highway contracts. WSDOT relied on and followed the regulations and guidance provided concerning the implementation of the regulations. For Federal Fiscal Year (FFY) 2007, WSDOT has established a proposed overall DBE goal of 18.77%, with no Step 2 adjustment.

Pursuant to 49 CFR §26.45, WSDOT followed a two-step process for setting its overall DBE goal for FFY 2007. The first step is the calculation of a base figure for the relative availability of DBEs. The second step is a possible adjustment of the base figure to reflect the effects of the DBE Program and the level of participation that would be expected "but for" the effects of past and current discrimination against DBEs. Finally, as further required by 49 CFR §26.51(c), WSDOT submits a projection of the portion of the overall goal that it expects to meet through race-neutral means and the basis for the projection.

This methodology and the supporting evidence fully comports with the federal regulations, as well as the decisions in *Sherbrooke Turf, Inc. v. Minnesota Department of Transportation*, 345 F.3d 964 (8th Cir. 2003), *cert. denied*, 124 S.Ct. 2158 (2004); *Western States Paving Co. v. Washington State Department of Transportation*, 907 F.3d 963 (9th Cir. 2005); *Northern Contracting Inc. v. Illinois Department of Transportation*, 2005 U.S. Dist. LEXIS 19868 (N.D. Ill. Sept 8, 2005); see also *Concrete Works of Colorado Inc. v. City and County of Denver*, 321 F.3d 950 (10th Cir. 2003), *cert. denied*, 124 S.Ct. 556 (2003) (Denver's program was constitutional based upon a similar methodology by the same consultant); *Builders Association of Greater Chicago v. City of Chicago*, 298 F.Supp.2d 725 (N. D. Ill. 2003) (Chicago's Minority and Women Business Program was based upon similar "strong evidence").

I. Methodology and Evidence

To meet the requirements of 49 CFR §26.45, WSDOT commissioned an Availability Study, entitled "Race, Sex, and Business Enterprise: Evidence from the State of Washington" ("Study"), from NERA Economic Consulting (NERA), a nationally recognized economics consulting firm (Attachment A). WSDOT relied upon this Study in setting its FFY 2007 goal.

The Study provides a statistical analysis of baseline DBE availability, and examines econometric evidence of disparities between DBEs and non-DBEs in factors impacting entrepreneurial success on WSDOT contracts and subcontracts. In particular, for Step 1, the Study estimated statewide DBE availability using data on WSDOT's expenditures for highway construction and

engineering consulting contracts and subcontracts, and carefully constructed databases of firms in those industries. To address Step 2, the Study reviewed existing quantitative evidence of discrimination and assessed the likelihood that statewide DBE availability would be different if the relevant markets in which WSDOT operates were race-neutral; it then estimates the magnitude of this difference. The Study's results are summarized below.

Recent favorable judicial decisions as well as USDOT's approval of other recipients' goals based upon NERA studies give WSDOT confidence in the Study's methodology, constitutional validity and narrowly tailored results. This approach has been upheld by the Eighth Circuit Court of Appeals in the challenge to Minnesota's 2001 DBE Program, and most recently by the trial court in a similar challenge to the Illinois Department of Transportation's DBE Program based upon a NERA Study. The Eighth Circuit's analysis was also adopted by the Ninth Circuit in *Western States*.

As required by the *Western States* decision, the Study provides a narrowly tailored, statistically sound and detailed basis to meet the requirements of 49 CFR, Part 26, and fully addresses the remedial purpose of the DBE Program and Congressional intent.

In addition to a comprehensive and detailed methodology to establish the Step 1 baseline figure of current DBE availability, the Study further examines disparities between the rates of business formation and the earnings from those businesses between DBEs and similarly situated white males. This analysis supports the inference that discrimination continues to impede the ability of minority- and women-owned firms to compete fully and fairly for WSDOT prime contracts and subcontracts. This is precisely the type of evidence that WSDOT must consider in determining whether to make an adjustment under Step 2. As recognized by the Illinois court in finding the Illinois Department of Transportation's DBE Program based in part upon a similar study, to be narrowly tailored, "[e]vidence of discriminatory barriers to the formation of businesses by minorities and women and fair competition between [DBEs] and majority-owned construction firms shows a 'strong link' between a government's 'disbursements of public funds for construction contracts and the channeling of those funds due to private discrimination.' Evidence that private discrimination results in barriers to business formation is relevant because it demonstrates that [DBEs] are precluded at the outset from competing for public construction contracts. *Concrete Works*, 321 F.3d at 977 (internal citations omitted). Having established the existence of such discrimination, a governmental entity 'has a compelling interest in assuring that public dollars, drawn from the tax contributions of all citizens, do not serve to finance the evil of private prejudice.' Croson, 488 U.S. at 492." *Northern Contracting*, at 82-83 (footnote and internal citation omitted).

The Study's data may also assist WSDOT in setting contract goals to reach its overall, aspirational DBE goal for federally-assisted contracts, based upon the

detailed four digit Standard Industrial Classification estimates included in the Study.

A. Step 1 Estimate of Relative Availability of DBEs

Using empirical market definitions, business establishment data and statistical verification surveys, the Study estimated 18.77% as the Step 1 base availability figure for DBE availability in the highway transportation construction industry in Washington State.

1. Definition of WSDOT's Contracting Market

The first element in estimating DBE availability is to determine empirically the relevant product and geographic markets for WSDOT's federally-assisted contracts. Based upon four years of WSDOT's contract and subcontract expenditure data, a total of 32 four-digit Standard Industrial Classification (SIC) codes¹ were identified as WSDOT's product market, and the State of Washington was identified as the geographic market. This approach incorporates the guidance of USDOT to use 4-digit SIC codes and to weight that data by WSDOT's expenditures.² It also separates firms by detailed function, delineating, for example, general contractors from specialty trade firms that primarily act as subcontractors on WSDOT projects.

2. Counting Establishments in WSDOT's Relevant Markets

The Study next examines the availability of DBEs in the relevant markets. It uses Dun & Bradstreet's *Marketplace* database, an independent and established data source routinely relied upon by courts, to identify the total number of Washington businesses in each four-digit SIC code, weighted by that code's share of WSDOT's product market. It next identifies the number of firms owned by minorities and women, based upon the information in *Marketplace*, WSDOT's DBE directory and other regional listings. As noted by USDOT's guidance, supplementing the DBE Directory with other information on minority- and women-owned firms may provide a more complete picture of the availability of firms to work on WSDOT contracts than reliance solely upon the number of WSDOT certified and prequalified and preregistered DBEs. Because of the possible misclassification and non-classification of firms from these sources, additional scientifically accepted safeguards were taken to verify listed DBEs and estimate unlisted DBEs. This approach to estimating DBE availability was specifically noted with approval in *Northern Contracting*.

B. Step 2 Consideration of Adjustment to the Base Figure

¹ SIC codes can be converted into the North American Industry Classification System (NAICS) codes now adopted for some purposes by the U.S. Census Bureau.

² <http://osdbuweb.dot.gov>.

Step 2 requires that WSDOT examine all evidence of discrimination in its jurisdiction to determine what adjustment, if any, is needed to the base figure to arrive at the overall goal that reflects estimated DBE availability in a discrimination free market, and whether such discrimination renders WSDOT likely to meet its goal without the use of race-conscious subcontracting goals on appropriate projects. Included among the types of evidence that must be considered pursuant to 49 CFR §26.45(d) are the current capacity of DBEs to perform work on WSDOT's federally-assisted contracts, as measured by the volume of work DBEs have performed in recent years, and evidence from disparity studies conducted anywhere within WSDOT's jurisdiction, to the extent not already accounted for in the base figure. WSDOT must also consider any available evidence from related fields that affect the opportunities for DBEs to form, grow and compete. These include, but are not limited to, statistical disparities in the ability of DBEs to get the financing, bonding and insurance required to participate in the DBE Program, and data on employment, self-employment, education, training and union apprenticeship programs, to the extent relevant to the opportunities for DBEs to perform in the Program. The regulations caution that any adjustment to the base figure to account for the continuing effects of past discrimination or the effects of an ongoing DBE Program must be based on "demonstrable evidence that is logically and directly related to the effect for which the adjustment is sought." 49 CFR §26.45(d) (3). Each of these categories is discussed separately below.

1. Past DBE Utilization

WSDOT considered the current capacity of DBEs to perform on its federally-assisted contracts, measured by the volume of work DBEs have received in recent years. There have been large fluctuations in DBE participation over the last several years as well as some changes in WSDOT's data collection procedures and goal setting methodologies.

FFY	DBE Participation on Federally-funded Contracts
1999	19.45%
2000	10.81%
2001	12.35%
2002	13.81%
2003	8.51%
2004	9.66%
2005	6.60%
2006	5.92%

2. Evidence from Local Disparity Studies

The next type of evidence that must be considered is any disparity study conducted by a local government in the state. The only local disparity study, conducted for the 1999 Puget Sound local governments, is not sufficiently current, relevant or reliable to form the basis for an adjustment.

3. Study's Statistical Evidence of Disparities

To provide a quantitative analysis of the effects of discrimination in WSDOT's marketplace, the Study examined disparities in Washington in earnings and business formation rates between DBEs and non-DBEs based upon the 2000 PUMS and Census Bureau's Current Population Survey (CPS).

a. Disparities in Earnings

The Study analyzed whether minority and female entrepreneurs earn less from their businesses than do their White male counterparts. Other things being equal, if minority business owners as a group have lower earnings from their businesses than comparable non-minorities, economic theory suggests that minority business failure rates will be higher and minority business formation rates will be lower than those that would be observed in a race-neutral marketplace. Applying linear regression to assess whether minorities earn less than Whites with similar characteristics, the Study concluded that similarly situated minorities and women, especially Blacks, earn less than their comparable White male counterparts.

b. Disparities in Business Formation

Likewise, the Study examined whether more minority businesses would have been formed if minorities were as likely to own their own businesses as were similarly situated White males, and if so, how many more such businesses would have been expected to be formed but for discrimination. Using Probit regression to control for age, industry and education, the Study found large and statistically significant disparities in the business formation rate for DBEs.

c. DBE Availability "but for" Discrimination

Using the statistical data on disparities, the Study estimated that DBE availability in Washington in a race-neutral market would be approximately 54.6% higher than the Step 1 estimate, for an estimated availability of DBEs "but for" discrimination of 28.12% in a fully race-neutral, remediated and non-discriminatory market. The base figure is depressed because discrimination has impacted the likelihood that minorities and women will become entrepreneurs and that when they do those firms are likely to be less profitable and to fail more frequently.

4. DBE Utilization on No-Goals Contracts

One indicator of the need to continue to apply race-conscious measures is the participation of DBEs in the absence of those measures. The results of unremediated markets were an important component of Illinois' successful defense of the DBE Program in the *Northern Contracting* case.

To comply with the appellate court's opinion in *Western States*, WSDOT suspended the use of DBE contract goals beginning May 9, 2005. Since that time, contractual obligations to DBE have fallen to under 6%, including contracts awarded before the court's opinion with DBE goals, from an average of 12% from 1999-2005.

This precipitous and drastic decline in DBE participation, after WSDOT's use of DBE contract goals was suspended, provides strong support for the conclusion that ongoing discriminatory effects persist in the Washington marketplace. Such declines were noted by the courts in the *Sherbrooke*, *Western States* and *Northern Contracting* cases in holding the revised Part 26 to be facially constitutional because race-neutral measures have proven to be inadequate to ameliorate discrimination. As noted by the Ninth Circuit, Congress properly recognized that "[a]fter the ... *Croson* decision, many state and local governments removed affirmative action provisions from their public contracts. This prompted a significant drop in racial minorities' participation in the construction industry."³ The Eighth Circuit further relied upon this evidence in holding Minnesota DOT's implementation of the new regulations to be constitutional as applied.

Likewise, expert testimony in the *Northern Contracting* and *BAGC v. Chicago*⁴ trials documented the experiences of other state and local governments whose race-conscious programs have either been enjoined or that do not set goals on locally-funded transportation contracts. In the absence of DBE programs, utilization of minority- and women-owned construction firms dropped dramatically below availability in all jurisdictions.

Washington saw a similar decline in its state-funded contracts after race- and gender-conscious contract goals were prohibited. WSDOT's Study compared DBE participation on federally-funded contracts with goals versus non-federally-funded contracts without goals.⁵

³ 407 F.3d at 992.

⁴ 298 F.Supp.2d 725 (N.D. Ill. 2003).

⁵ WSDOT is prohibited from setting race- and gender-conscious goals on state funded contracts pursuant to Initiative 200, as passed in November 1998 and codified as RCW 49.60.400.

FFY	DBE Participation on State funded no-goals contracts⁶
2000	5.65%
2001	6.24%
2002	.12%
2003	4.09%
2004	4.49%
2005	3.66%

DBEs' participation on state-funded no-goals contracts was below the estimate of their availability, which suggests that race-conscious subcontracting goals on appropriate contracts will be needed to meet WSDOT's proposed goal of 18.77%.

5. Anecdotal evidence

In addition to the statistical evidence of discrimination provided in the Study, WSDOT gathered anecdotal evidence of discrimination. WSDOT conducted focus groups of DBEs and non-DBEs, exploring the participants' experiences with discrimination, bidding and performing WSDOT contracts and in accessing the financing, bonding, networks, etc., necessary for business success. WSDOT also held public meetings to elicit comments on DBEs' experiences since goals were suspended and the proposed Interim FFY 2006 DBE goal

The Focus Group Report is attached (Attachment B).

Most DBEs reported experiencing significant racial, ethnic and gender barriers to their full and fair participation in WSDOT's market place. These included:

- The perception that they are inherently less competent and professional than their White male counterparts.
- The imposition of higher performance standards.
- Harassment and disparate treatment at worksites.
- Exclusion from industry and professional networks.
- Discrimination by lenders and sureties.
- Discrimination by trade unions.
- Very limited non-goals opportunities, including for public sector prime contract opportunities.

⁶ 2001-2003 data are from the Availability Study; 2004-2005 data are from the Semi-Annual Reports filed with FHWA.

- Limitations on subcontracting scopes of work to no more than affirmative action goals.
- Substitution by prime contractors after contract award.
- Retaliation for complaining about poor treatment.
- Immediate and drastic reduction in solicitations and subcontract awards after WSDOT's suspension of contract goals.

Many non-DBE general contractors found the DBE Program requirements difficult and burdensome because:

- Goals were unrealistic.
- There is insufficient availability of qualified DBEs.
- Work that they preferred to self-perform was subcontracted to DBEs.
- Waivers were believed to be unavailable.

Non-DBE prime design consultants' experience of the Program was less burdensome, although they too experienced:

- Limited availability of qualified DBEs.
- Increased project management responsibilities and attendant costs from using DBEs.

Some non-DBE subcontractors that compete against DBEs felt that they suffered race and gender discrimination as a result of the DBE goals.

- DBEs were used to meet goals even when they provided higher quotes than non-DBEs.
- Small design firms had few opportunities because large firms prefer not to team unless it is to meet DBE goals.

In addition, WSDOT held a series of public meetings to solicit information about whether minorities and women continue to suffer from discrimination in WSDOT's marketplace. DBE commentators universally supported reinstituting the application of race-conscious goals on WSDOT projects. There was agreement that without the use of contract goals, prime contractors will rarely use or even solicit DBEs. "You don't even get a call," explained one contractor. The result is similar to that of the passage of I-200, which resulted in a number of construction and consultant firms going out of business. For example, a DBE lost contracting opportunities in the second phase of construction without DBE goals after successfully obtaining subcontracting work and having the original contract increased in the first phase. When the second phase of construction was advertised with DBE goals, he purchased construction equipment costing over \$850,000.00 in anticipation of the project. After the goals were suspended, he was no longer utilized; he is now burdened with paying for the equipment without

the original or other projects to pay for the equipment. None of the non-DBEs made comments at the public meetings.

Based upon this anecdotal information, together with the results of the Study, WSDOT concluded that discrimination still limits the opportunities for DBEs of all racial and ethnic groups and white women to perform on its prime contracts and subcontracts. Therefore, to narrowly tailor its Program and to achieve the Program's objective of creating a level playing field for all firms, WSDOT must judiciously apply contract goals on appropriate solicitations to achieve its overall annual goal.

If funds become available, WSDOT will undertake the kind of business experience and credit discrimination surveys that received judicial favor in the *Northern Contracting*, *Chicago* and *Denver* cases.

6. Step 2 Adjustment Evaluation

The federal regulations caution that any adjustment to the Step 1 base figure to account for the continuing effects of past discrimination or the effects of an ongoing DBE program must be based on "demonstrable evidence that is logically and directly related to the effect for which the adjustment is sought." 49 CFR §26.45(d) (3).

WSDOT determined that the past participation of DBEs should not be used to adjust the Step 1 base figure. First, there is no evidence that DBEs are being overutilized relative to their availability and capacity. To the contrary, WSDOT's utilization of DBEs is below the baseline estimate of DBE availability, and utilization continues to decline since the use of contract goals was suspended. Therefore, relying upon past participation to define current capacity in determining the goal for a non-discriminatory market is inapposite for WSDOT.

All of the evidence described above supports the qualitative judgment that, but for the continuing effects of discrimination, the availability of minorities and women to participate on WSDOT's contracts would be considerably higher than 18.77% in a race-neutral, non-discriminatory market. The Study provides a quantitative estimate of the degree to which discriminatory factors artificially depress DBE participation in WSDOT's marketplace and establishes a basis of an upward adjustment of the base figure. While the statistical disparities established by the Study could serve as the basis for an upward adjustment of the base figure, WSDOT believes that an upward adjustment is not warranted for the upcoming Federal Fiscal Year, in view of the low utilization of DBEs in FFY 2006.

II. Projection of Race-Neutral vs. Race-Conscious Goal Attainment

WSDOT will meet the maximum feasible portion of its overall goal through race-neutral means. The ongoing initiatives described below seek to reduce discriminatory barriers, increase capacity and level the playing field for the participation of DBEs and other small contractors. They are also designed to assist WSDOT in meeting the increased goal for DBE participation as prime contractors and subcontractors and to increase race-neutral participation on its contracts.

To estimate the portions of the goal to be met through race-neutral and race-conscious measures, WSDOT evaluated past race-neutral DBE participation as defined in 49 CFR §26.51(a). Following the guidance of USDOT, WSDOT's median race-neutral participation for FFY 2001 through FFY 2006 was 4.07%.

Therefore, WSDOT projects that it will meet 4.07% of its overall goal of 18.77% through race-neutral measures and 14.70% of its overall goal through race-conscious contract goals based upon that median race-neutral participation.

WSDOT will monitor DBE participation throughout the year to adjust its use of contract goals to ensure that their use does not exceed the overall goal.

III. Race-neutral initiatives

WSDOT will meet the maximum feasible portion of its overall goal through the race-neutral measures listed below.

A. Supportive services

WSDOT provides the following supportive services to DBEs and other small firms through the State's Office of Minority and Women's Business Enterprises (OMWBE):

- Immediate and long-term business management, record keeping, financial and accounting capabilities;
- Long-term development assistance to increase opportunities to participate in more varied and significant work, and to achieve eventual self-sufficiency;
- Programs on contracting procedures and specific contract opportunities;
- Assistance in obtaining bonding or financing;
- Assistance to start-up firms, particularly in fields with historically low DBE participation; and
- Identification of potential highway-related DBEs and prequalification assistance.

B. Outreach and Networking

WSDOT engages in a number of outreach efforts to minority and women's organizations to enhance DBE opportunities in Department projects. These efforts include but are not limited to:

- Sponsorship of the annual Regional Contracting Forum held in Seattle, Washington, in partnership with state, local and federal agencies. This event attracts over 400 firms interested in doing business with WSDOT and other agencies and provides direct one-on-one outreach to firms.
- WSDOT works with organizations such as the Northwest Minority Business Development Council, Women in Construction, USDOT's Minority Resource Center Disadvantaged Business Enterprises Council, the Women's Transportation Seminar and other groups to promote the DBE Program.
- WSDOT has established a Washington State DBE Resource Group that will advise us on DBE issues, included but not limited to, goal setting, outreach, training, etc.

C. Complaint Procedures

WSDOT has implemented procedures to process complaints of discrimination in the operation of the DBE Program and against contractors receiving WSDOT contracts. This will ensure prompt, uniform and fair responses to allegations of unlawful conduct so that DBEs, non-DBEs and interested persons can have confidence in the integrity of WSDOT's operations.

D. Prompt Payment

WSDOT continues to enforce its prompt payment provisions and processes. It impresses upon its personnel and prime contractors the necessity and importance of meeting these requirements.

E. Emerging Contractor Support Initiatives

WSDOT recognizes the necessity of developing new and innovative race-neutral contractor support services and will begin identifying potential programs and resources during FFY 2007. The process will include soliciting input from the DBE Resource Group and from construction and DBE organizations in this and other states.

IV. Public Participation

To satisfy the public consultation requirements of the regulations, WSDOT has provided a press release to all media outlets in Washington State and published the proposed annual goal for FFY 2007 in the Seattle Daily Journal of Commerce, Yakima Herald-Republic, The Columbian, the Northwest Asian Weekly, El Mundo, and the Spokane Spokesman Review. Included in its press release and publication is WSDOT's request for public comment and inspection of the goal methodology for 45-days from date of publication. WSDOT will hold stakeholders' meetings throughout the State to explain the methodology used to establish the goal and take public comments. The proposed goal is also available for review on WSDOT's webpage. WSDOT will evaluate comments received during this period, make adjustments to the goal if necessary, and forward the revisions to FHWA for review and approval as part of its final goal submission.